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Review of Crop Insurance and Commodity Programs

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Written Testimony

Mr. Chairman and members of the committee, my name is Howard Olson. I am Vice-President of Insurance at AgCountry Farm Credit Services, based in Fargo, ND. I appreciate the opportunity to testify before you concerning the effectiveness of the crop insurance program.

The crop insurance program is a valued risk management tool and necessary safety net for agriculture producers in the northern plains. In 1996, with the passage of the Freedom to Farm bill, farmers were encouraged to use crop insurance and marketing tools as a safety net for farm income. Since 1996, in the states of Minnesota and North Dakota, $1,153,000,000 in premiums has been paid by farmers. In those same years $2,270,000,000 was paid in claims.[1] The crop insurance program not only provides protection for production, but with the introduction of Crop Revenue Coverage and Revenue Assurance in the last eight years it has become a valued marketing tool, providing protection for changes in commodity prices. This has given producers the opportunity to do a better job of marketing and ultimately improving their gross income.

As an agricultural lender, AgCountry Farm Credit Services sees firsthand the value that crop insurance has brought to the farmers in our area. It brings additional income security to a farm operation and allows many farmers to get credit that otherwise could not. It has been estimated that 15-20% of the farmers in Norman and Mahnomen counties would be unable to obtain credit without the crop insurance program.

Crop losses have a significant impact on even a farmer with a strong balance sheet. A farmer with good working capital that suffers an uninsured loss will need five to seven years of good crops to recover from that loss. The loss of working capital has an impact on the farmer's ability to replace equipment, stay current with technology, compete with other producers and increases the risk of financial failure. That risk also has an impact on all of the suppliers that the farmer purchases goods and services from throughout the crop year, ultimately impacting the entire community. AgCountry continues to see how the crop insurance program is providing a stronger borrowing base for agriculture customers bringing better protection and a strong safety net for the producer and the community.

As good as the crop insurance program is, there is still room for improvement. The Agriculture Risk Protection Act of 2000 made tremendous contributions to improving the premium subsidy, and everyone is very appreciative of that. ARPA brought affordability to coverage levels that provide true protection.

However, it is still difficult for farmers to purchase as much coverage as they need to protect their input costs. Repetitive years of losses have caused Actual Production History (APH) to fall. Even at 75% coverage levels, it is common to find farmers in Northern Minnesota with only $80-$100 an acre of coverage on their wheat, while their actual costs for raising wheat are close to $150 to $170 an acre. The coverage that is available is not enough to make them whole.

The problem arises when there is a disaster year included in the APH. The current rules allow replacing the bad year in the APH with a yield equal to 60% of the county Transition Yield (T-yield). Some suggestions for improvement would be to use a yield adjustment equal to 100% of the county T-yield, or remove years in the APH were the county has been declared a disaster.

T-yields should be examined and reviewed for accuracy. T-yields are supposed to be based on the National Agriculture Statistical Service (NASS) yields. However there is a discrepancy between the T-yields and the NASS yields. Another situation that arises is that current technology and product developments have provided for an increasing trend line yield of all crops, especially corn and soybeans. The NASS yields and the T-yields lag the trend line yield because they are a long-term average and are not responsive enough to the change in the trend line yield.

Another solution is to have the yield floor at 100% of T-yield instead of the current 80% of T-yield. New producers of a crop are eligible to receive 100% of the county T-yield so experienced producers of a crop should be able to do the same.

Another common problem in this area is a discrepancy between quality adjustments in the crop insurance program and the quality discounts at the local elevators. Just recently a local producer stated that the local elevator discounted 53-pound test weight wheat by 75¢. 75¢ on $3.50 wheat is a 21% discount. The crop insurance program doesn't provide coverage for low test weight until the wheat is below 50 pounds. In the past few years, discounts for falling numbers have become common in wheat and durum. The crop insurance program does not provide any quality adjustments for falling numbers. The Commodity Credit Corporation's (CCC) grading standards have been recently modified to include discounts for falling numbers. In comparing crop insurance quality adjustments with CCC grading standards we see a significant difference in how the two are applied. In the very least the crop insurance program should have the same standards as the CCC program and at best reflect the exact discounts that are taken at the elevator.

New producers of a crop receive 100% of the county T-yield as their APH yield. But if the producer raised the crop twenty years ago they are required to use that production or they will receive a percentage of the county T-yield. This procedure penalizes a producer for having raised a crop many years ago because today's yield potential is much greater than it was twenty years ago.

Crop insurance coverage on sugar beets and adjusting procedures on sugar beets should be reviewed for the effectiveness or lack of effectiveness of having two stage guarantees. While it is true that sugar beets occur significant costs throughout the growing season, the majority of the cost has gone into the beets by planting. Having a different guarantee before July 1st and after July 1st causes errors and frustration in the program and differences in procedures by growers, adjusters and companies. Sugar beets could be covered in a very similar fashion as potatoes. If potatoes are destroyed before harvest, they are covered at 80% of the guarantee.

In working in both North Dakota and Minnesota there is often a disparity in coverage on crops that are only a stone's throw across the Red River from each other. One example of this is the sugar index factor used for adjusting sugar beet yields. The factors in North Dakota were recently raised while the factors in Minnesota stayed at the current levels. The result is a difference in APHs on either side of the river. There are other differences between states in how Added Land is reviewed and approved, documentation required for Written Agreements and approval of Written Agreements. The reason for the differences is the different RMA Regional Offices. The process should be the same for the same crops in similar growing areas for all RMA Regional Offices.

In summary crop insurance can be a better safety net with some improvements. Bolstering of APHs when hit by disaster years, improvements in the quality adjustments, T-yields tracking closer to trend line yields, better yields for new producers of a crop, one sugar beet guarantee for the crop year and common practices and procedures between RMA Regional Offices would all be valued improvements.

U.S producers have a good safety net in the crop insurance program. The program provides valuable risk management tools for farmers. It helps farmers eliminate the financial disaster of crop losses. Crop insurance also allows farmers to do a better job of marketing, reducing marketing risk and providing marketing opportunities. Crop insurance gives agriculture lenders additional security for operating loans, allowing them to extend credit to customers who may not otherwise be able to get credit while improving the financial stability of the agriculture credit system. The crop insurance program provides a downstream affect of more financial stability to the rural communities and economy. Farmers in North Dakota and Minnesota use crop insurance as their primary risk management tool to mitigate production and marketing risks. Let's work together to make it a better program for everyone.

1 - Crop insurance premium and loss data is from RMA's Summary of Business Reports.